



Mercury General (MCY)

Updated May 19th, 2021 by Jonathan Weber

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|----------------------------------|----------|
| Current Price: | \$66 | 5 Year CAGR Estimate: | 2.8% | Market Cap: | \$3.7B |
| Fair Value Price: | \$59 | 5 Year Growth Estimate: | 1.5% | Ex-Dividend Date: | 06/15/21 |
| % Fair Value: | 113% | 5 Year Valuation Multiple Estimate: | -2.4% | Dividend Payment Date: | 06/30/21 |
| Dividend Yield: | 3.8% | 5 Year Price Target | \$63 | Years Of Dividend Growth: | 33 |
| Dividend Risk Score: | C | Retirement Suitability Score: | B | Last Dividend Increase: | 0.4% |

Overview & Current Events

Mercury General is an insurance company that is active in the following businesses: automobile, homeowners, renters & business insurance. Mercury was founded more than 50 years ago, in 1961. Personal automobile insurance is the most important business unit for Mercury General. The company is active in eleven states, with California being the most important market. Insurance is primarily sold through about 10,000 independent agents.

Mercury General reported its first quarter earnings results on May 4. The company reported revenues of \$1.0 billion for the quarter, which was up 4% compared to the previous year's period. Net premiums written declined 0.4% year over year, to \$950 million. The fact that net written premiums were down year over year will likely mean that earned premiums could be under pressure during coming quarters. Mercury General's investment income and investment gains improved by a lot during the quarter, as net realized investment gains rose to \$33 million for the quarter, versus a net investment loss, on a GAAP basis, during the previous year's quarter, which had been negatively impacted by the equity market downturn in spring 2020 that was caused by the pandemic.

Mercury General's adjusted earnings-per-share totaled \$1.34 during the first quarter, beating the analyst consensus estimate easily. The adjusted result backs out one-time accounting items. The coronavirus hasn't had a meaningful impact on Mercury General's profitability so far. 2020 was a strong year for Mercury, as earnings-per-share were higher than during all previous years, at \$5.54, although it is expected that 2021 will be a somewhat weaker year again.

Growth on a Per-Share Basis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS | \$2.79 | \$2.13 | \$2.18 | \$2.28 | \$2.34 | \$1.73 | \$1.64 | \$1.80 | \$2.60 | \$5.54 | \$3.90 | \$4.20 |
| DPS | \$2.41 | \$2.44 | \$2.45 | \$2.46 | \$2.47 | \$2.48 | \$2.49 | \$2.50 | \$2.51 | \$2.52 | \$2.53 | \$2.59 |
| Shares¹ | 54.9 | 54.9 | 55.0 | 55.1 | 55.2 | 55.3 | 55.3 | 55.3 | 55.3 | 55.4 | 55.5 | 56.0 |

Mercury's growth history is relatively weak. From 2009 to 2018 the company's earnings-per-share declined. 2016 and 2017 were two especially harsh years, primarily due to unusually high costs for catastrophes such as the California wildfires during the summer of 2017. During 2019 Mercury's earnings-per-share recovered, however, due to lower catastrophe losses, but profits remained below the level that was hit in 2011, almost a decade earlier.

2019 had been a solid year for Mercury, but profits during 2020 rose to a way higher level, partially due to below-average catastrophe losses. The pandemic did not negatively impact the company's results during 2020, and the same can be expected for the current year, but higher losses for Mercury's ordinary business are expected for this year.

In the future, the company should be able to grow its profits slightly, we believe, although there likely will be big swings on a year-over-year basis, as there have been major changes in its profitability in the past. These cyclical results, caused by one-time impacts such as wildfires or hurricanes are not unusual for insurance companies with a regional focus, and they are something investors have to live with when they want to invest into Mercury General. These are not tied to the underlying strength of the economy, however, which is why Mercury's cyclical nature is not tied to recessions.

¹ In Millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Now | 2026 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E | 14.5 | 19.6 | 20.1 | 21.5 | 23.1 | 30.8 | 35.0 | 28.9 | 18.8 | 9.2 | 16.9 | 15.0 |
| Avg. Yld. | 6.0% | 5.8% | 5.6% | 5.0% | 4.6% | 4.7% | 4.4% | 5.1% | 5.1% | 5.0% | 3.8% | 4.1% |

Mercury General's shares traded at quite high valuations throughout the last couple of years, with the company's price-to-earnings ratio being above 20 between 2013 and 2018. This was mostly due to the below-average profitability during those years. Based on current earnings forecasts for 2021, Mercury's shares trade slightly above fair value.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|--------|-------|------|------|------|------|------|------|------|-------|-------|-------|-------|
| Payout | 86.4% | 115% | 112% | 108% | 106% | 143% | 152% | 139% | 96.5% | 45.5% | 64.9% | 61.7% |

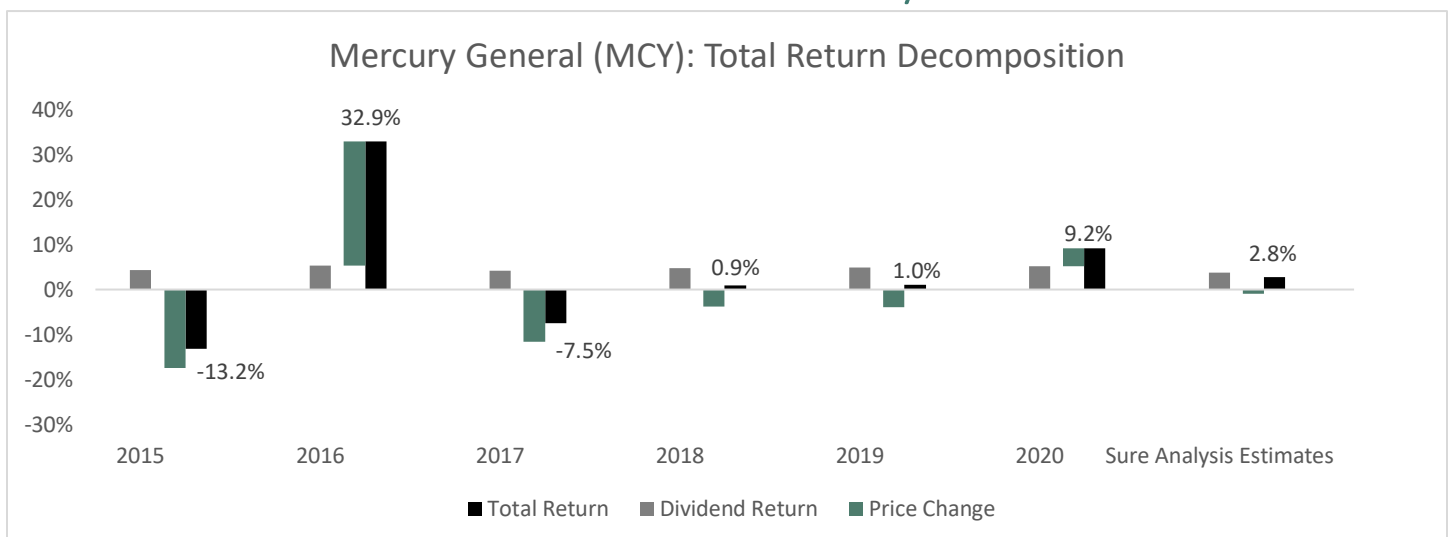
Mercury General has paid out more than 100% of its reported net earnings throughout most of the last decade. The company nevertheless managed to increase its dividend payout throughout the years, although the dividend growth rate was quite low in recent years, at less than 1% annually. Mercury General has been able to finance its dividend thanks to cash flows that are higher than the net profits that the company generates.

During the last financial crisis Mercury remained profitable, which can be explained by two key factors. First, even during times when the economy is weak, people still need insurance for their cars, property, and other belongings. Demand for Mercury's offerings is thus not overly dependent upon the economy. Second, Mercury did not invest in high-risk assets prior to the financial crisis, and therefore was able to avoid the huge losses many other financial corporations had to report. Mercury overall is recession-proof, which is a plus. But the company is significantly more impacted by catastrophes that affect its operations directly, such as 2017's huge California wildfires.

Final Thoughts & Recommendation

Unlike most of its peers from the financial industry, Mercury General was relatively resilient during the last financial crisis. Mercury General's earnings growth has been very inconsistent, however, and even though 2020 was a strong year, 2021 looks like it will be a weaker year once again. Unforeseen catastrophes such as wildfires can impact results to a large degree. Due to unconvincing expected returns, we rate Mercury General a sell at the current level.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|----------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 2,777 | 2,783 | 2,821 | 3,012 | 3,009 | 3,228 | 3,416 | 3,380 | 3,973 | 3,785 |
| D&A Exp. | 41 | 37 | 31 | 28 | 48 | 53 | 55 | 59 | 65 | 68 |
| Net Profit | 191 | 117 | 112 | 178 | 74 | 73 | 145 | (6) | 320 | 375 |
| Net Margin | 6.9% | 4.2% | 4.0% | 5.9% | 2.5% | 2.3% | 4.2% | -0.2% | 8.1% | 9.9% |
| Free Cash Flow | 140 | 133 | 191 | 220 | 170 | 275 | 322 | 355 | 480 | 566 |
| Income Tax | 54 | 18 | 20 | 69 | (4) | (2) | 22 | (25) | 58 | 84 |

Balance Sheet Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|----------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets | 4,070 | 4,190 | 4,315 | 4,600 | 4,629 | 4,789 | 5,101 | 5,434 | 5,889 | 6,328 |
| Cash & Equivalents | 211 | 158 | 267 | 290 | 264 | 220 | 291 | 314 | 294 | 348 |
| Accounts Receivable | 289 | 345 | 366 | 390 | 437 | 472 | 530 | 776 | 684 | 638 |
| Goodwill & Int. Ass. | 97 | 90 | 84 | 78 | 74 | 68 | 64 | 58 | 53 | 54 |
| Total Liabilities | 2,213 | 2,347 | 2,493 | 2,725 | 2,808 | 3,036 | 3,340 | 3,816 | 4,090 | 4,296 |
| Accounts Payable | 95 | 96 | 128 | 131 | 123 | 112 | 108 | 115 | 143 | 194 |
| Long-Term Debt | 140 | 140 | 190 | 290 | 290 | 320 | 371 | 372 | 372 | 373 |
| Shareholder's Equity | 1,857 | 1,842 | 1,822 | 1,875 | 1,821 | 1,752 | 1,761 | 1,618 | 1,800 | 2,033 |
| D/E Ratio | 0.08 | 0.08 | 0.10 | 0.15 | 0.16 | 0.18 | 0.21 | 0.23 | 0.21 | 0.18 |

Profitability & Per Share Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 4.6% | 2.8% | 2.6% | 4.0% | 1.6% | 1.6% | 2.9% | -0.1% | 5.7% | 6.1% |
| Return on Equity | 10.5% | 6.3% | 6.1% | 9.6% | 4.0% | 4.1% | 8.2% | -0.3% | 18.7% | 19.6% |
| ROIC | 9.4% | 5.9% | 5.6% | 8.5% | 3.5% | 3.5% | 6.9% | -0.3% | 15.4% | 16.4% |
| Shares Out. | 54.9 | 54.9 | 55.0 | 55.1 | 55.2 | 55.3 | 55.3 | 55.3 | 55.3 | 55.4 |
| Revenue/Share | 50.64 | 50.68 | 51.33 | 54.74 | 54.51 | 58.36 | 61.74 | 61.08 | 71.76 | 68.36 |
| FCF/Share | 2.56 | 2.42 | 3.48 | 4.01 | 3.08 | 4.97 | 5.82 | 6.42 | 8.66 | 10.22 |

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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